

# **CORRECTED FISCAL NOTE**

## **SB 20**

January 26, 2007

**SUMMARY OF BILL:** Increases the excise tax on cigarettes from 20 cents to \$1.00 per pack.

### **ESTIMATED FISCAL IMPACT:**

On January 17, 2007, we issued a fiscal note indicating *an increase to state revenues of \$386,676,000 (to be apportioned among various state funds), increases to state expenditures (\$200,000 recurring and \$75,300 one-time), and an increase to local government revenues of \$3,288,000.* Based on new information concerning the elasticity of demand for cigarettes, the fiscal impact of this bill is:

#### **(CORRECTED)**

**Increase State Revenues – \$381,747,000 / Education Fund  
\$2,445,000 / General Fund  
\$31,000 / Department of Revenue  
\$77,000 / Sinking Fund**

**Increase State Expenditures - \$200,000 Recurring  
\$75,300 One-Time**

**Increase Local Govt. Revenues - \$3,095,000**

#### Assumptions:

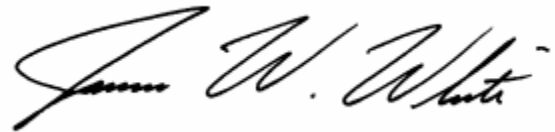
- According to the Department of Revenue (DOR), excise tax collections on cigarettes in FY05-06 were approximately \$115,462,000.
- Current excise tax rate on cigarettes is \$0.20 per pack.
- Estimated number of packs sold in FY05-06 was 577,310,000 (\$115,462,000 ÷ \$0.20 = 577,310,000 packs).
- Cigarette elasticity is estimated from a variable elasticity schedule depending upon the extent of any excise tax increase.
- Cigarette elasticity rate for proposed increase is estimated to be -0.593.
- Current state sales tax rate on cigarettes is 7.00%.
- Local option sales tax rate on cigarettes is estimated to be 2.25%.

- Current consumer price per pack is estimated to be \$3.19 per pack (excluding sales tax); \$3.48 per pack (including sales tax).
- Increasing the excise tax on cigarettes by \$0.80 per pack would also generate an additional \$0.07 per pack in state and local option sales tax revenue ( $\$0.80 \times 9.25\% = \$0.074$ ).
- The total price increase to the consumer is estimated to be \$0.87 per pack ( $\$0.80$  excise tax increase +  $\$0.07$  incremental sales tax =  $\$0.87$ ).
- Consumer price per pack after the proposed excise tax increase is estimated to be \$3.99 per pack (excluding sales tax); \$4.35 per pack (including sales tax).
- Increasing the excise tax on cigarettes would increase the per pack price to the consumer by an estimated 25.0% ( $\$0.87 \div \$3.48 = 25.0\%$ ).
- Quantity demanded would decrease by an estimated 14.825% (25.0% price increase  $\times$  -0.593 elasticity rate = -12.5% decrease).
- Quantity demanded in FY07-08 is estimated to be 491,724,000 packs ( $577,310,000 \times \{100.00\% - 14.825\%\} = 491,723,793$ ).
- Total excise tax collections are estimated to be \$505,146,250 ( $491,724,000$  packs  $\times$  \$1.00 excise tax = \$491,724,000) per year.
- Incremental excise tax collections are estimated to be \$376,262,000 ( $\$491,724,000 - \$115,462,000 = \$376,262,000$ ) per year.
- 100% of the estimated \$376,262,000 in incremental excise tax collections would be apportioned exclusively for public education, grades one through twelve.
- Sales tax collections will increase because sales tax is computed on the final retail sale (which includes any current and increased excise tax).
- Retail sales before the proposed excise tax increase are estimated to be \$1,841,619,000 ( $577,310,000$  packs  $\times$  \$3.19 old price (excluding sales tax) = \$1,841,618,900).
- Retail sales after the proposed excise tax increase are estimated to be \$1,961,979,000 ( $491,724,000$  packs  $\times$  \$3.99 new price (excluding sales tax) = \$1,961,978,760).
- Incremental retail sales are estimated to be \$120,360,000 ( $\$1,961,979,000 - \$1,841,619,000 = \$120,360,000$ ).
- Incremental state sales tax revenue is estimated to be \$8,425,000 ( $\$120,360,000 \times 7\%$  state rate = \$8,425,200) per year.
- The \$8,425,000 in incremental state sales tax revenue would be apportioned as follows: \$2,445,000 to the General Fund, \$5,485,000 for education, \$387,000 to local governments, \$31,000 to the Department of Revenue, and \$77,000 to the Sinking Fund.
- The net recurring increase to state revenues resulting from incremental state sales tax collections is estimated to be \$8,038,000 ( $\$8,425,000 - \$387,000$  local share = \$8,038,000).

- Three additional DOR staff members for Special Investigations to combat the expected increased flow of non-taxed/lower-taxed cigarettes into Tennessee from other states.
- The increase to recurring and one-time state expenditures associated with three additional Special Investigations Agents for the DOR is estimated to be \$200,000 and \$75,300 respectively.
- The total net recurring increase to state revenues is estimated to be \$384,024,700 (\$376,262,000 from additional excise tax + \$8,038,000 from incremental sales tax - \$275,300 one-time/recurring expenditures = \$384,024,700) per year.
- Incremental local option sales tax revenue is estimated to be \$2,708,000 (\$120,360,000 X 2.25% local option rate = \$2,708,100) per year.
- The total net recurring increase to local government revenues is estimated to be \$3,095,000 (\$2,708,000 in local option tax revenue + \$387,000 in state-shared sales tax revenue = \$3,095,000) per year.

**CERTIFICATION:**

This is to duly certify that the information contained herein is true and correct to the best of my knowledge.

A handwritten signature in black ink, appearing to read "James W. White". The signature is fluid and cursive, with a large initial "J" and a distinct "W".

James W. White, Executive Director